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Improve your returns with debentures

Invest in 5-6 issues to spread risk and hold these for the entire tenure

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With small savings rates, and bank fixed deposit (FD) rates coming under pressure, the risk-averse investor would be seeking debt products that offer slightly higher rates. The good news is that non-banking finance companies (NBFCs) are again lining up non-convertible debenture (NCD) issues.

YOUR MONEY

They are expected to offer retail investors 1.5-2.75 per cent higher rates than State Bank of India's long-term fixed deposit rate, currently 6.25 per cent.

In July, Mahindra & Mahindra Financial Services and Srei Equipment Finance are expected to hit the market with NCD issues. Being backed by a large corporate house, the Mahindra Financial NCD would be priced at between 7.5-8 per cent, said investment banking sources. Srei Equipment Finance's offering is expected to be 8.5-9 per cent. Two Tata group companies are expected to follow.

Wealth managers are quite enthused. "Retail investors can put a portion of their debt portfolio in high-rated papers but they need to select companies with a good record of repayment," says Shankar Raman, CIO — third part products, Centrum Wealth Management. The advice for investors in bank FDs is: spread investments over multiple issues to cut credit risk.

With returns on FDs down sharply, investors are lapping NCDs. Some earlier issues were oversubscribed on the first day of opening. For example, the ₹2,000-crore Muthoot Finance NCD, which opened on April 11, closed the very next day. It had allocated as much as 60 per cent of the issue for high net worth individuals and retail investors.

GOOD RETURNS IN A LOW INTEREST RATE REGIME

Company	Interest rates (%)	Opening date	Tenure (mths)
Muthoot Finance	8.25 - 9.00	Apr 11, '17	24-60
Srei International Finance	8.50-9.50	Jan 30, '17	14-60
Muthoot Finance	8.25 - 9.00	Jan 17,'17	24-60
Srei Equipment Finance	9.12-9.75	Jan 03, '17	36-60
Reliance Home Finance	8.90-9.40	Dec 22, '16	36-180

Source: Sebi prospectus

However, investment managers note that both instruments, FDs and NCDs, are not strictly comparable, though both offer fixed returns. The latter carries more risks than FDs and, therefore higher returns.

"A public bond issue requires much more compliance compared to those offered only to institutions. Final approval is given by the Securities and Exchange Board of India, after detailed scrutiny," says Ajay Manglunia, executive vice-president at Edelweiss Finance.

If your debt portfolio is not large, invest in four-five issues over the year. An investor should ideally spread investments across 8-10 issues, say investment managers. Those who set aside money every month for investment or don't have the risk appetite can look at five-year FDs from India Post, which offers 7.7 per cent interest. Unlike stocks, where brokerages track and publish detailed research reports, NCDs require an investor to do the homework.

Also, remember it is important to hold these NCDs for the entire tenure. "All bonds get listed nowadays. But, there's a lack of liquidity in the secondary market for NCDs," says Raman. He points out that the tax-free bonds that came in 2015 and perpetual bonds have more demand on stock exchanges than supply. Many wealthy people don't prefer NCDs due to liquidity issues.

For ones seeking more liquidity, MFs are a better option. Debt mutual funds hold a variety of paper that reduces risk in the overall portfolio. These can be redeemed in two working days. If held for over three years, debt MFs are taxed at 20 per cent, after taking the cost inflation index into consideration.

The tax outgo in this case reduces significantly. Bonds are taxed like FDs and so are debt MFs held for less than three years. The gains are added to income and taxed on the investor's slab rate.